

March 15, 2010

Chairmen Daily and Staples,
Members of the Finance, Revenue & Bonding Committee,

I am resident of the great state of Connecticut, and I am concerned that Bill No. 5481 would hurt thousands of my fellow Connecticut residents who are trying to earn extra income through affiliate advertising in these very tough economic times. The stated purpose of the bill is to specify that sales tax is due when an online retailer uses an in-state affiliate to sell its products. If this bill is passed, I believe there would be unintended consequences. As a result, the bill would not only fail to create new revenue for the state, but it would instead jeopardize entire affiliate commissions for Connecticut residents, and that would likely cause the state to lose a current income tax revenue stream. Allow me to explain why:

Affiliate advertising generally works like this: I place an affiliate advertising link on my website to items that a retailer is selling. If a buyer clicks on my link to get to the retailer's website, and they buy something from the retailer, then I get a percentage of the sale as a referral commission. The commission is earned because I made the buyer aware of a product that he or she would not have been aware of otherwise. A very important consideration in this entire transaction is that the buyer currently does not pay anything additional by clicking on my link. So the buyer does not mind that the affiliate advertiser is making a commission on the sale. This current arrangement is good for Connecticut because if I live in the state, my commissions are taxed just like any other income. Thus Connecticut currently makes money from affiliate advertisements.

But the proposed bill would instruct out-of-state retailers to single out Connecticut affiliates, by charging the buyer a Connecticut state sales tax if they came to the retailer's site from a Connecticut resident's affiliate link. I believe this will cause many undesirable effects. The most alarming is that retailers will likely drop relationships with all Connecticut affiliates. In that case, Connecticut will not only fail to get the sales tax, but it will also lose current income revenue from commissions as the commissions dry up.

But even if retailers continue to maintain relations with Connecticut affiliates, it will not take long for customers to figure out that they are suddenly being charged a Connecticut sales tax after they click on certain affiliate advertisements. They will learn to avoid those particular affiliate advertisements. This could create an environment where a resident's website has a competitive disadvantage because their links cause a customer to pay more money while an out-of-state competitor's website does not. The result would be reduced commissions for the in-state affiliate, and thus reduced income tax revenue for the state.

Worse yet, many savvy customers will learn that after they click on an affiliate link and see they are being taxed, they can simply close their browsers, clear their settings, and go back to the retailer's site directly. In this scenario, the retailer would not be able to tell that a sales was made through the Connecticut affiliate. Thus the tax would not be charged, the commission would be lost for the affiliate, and income tax revenue would be lost for the state.

I would also like to point out that through this bill, the state is asking for 6% of the retailer's sale, which is actually more money than the typical 5% commission that state-residing affiliates are receiving. This seems excessive to me, especially when considering that in the vast majority of the sales transactions neither the retailer nor the buyer will reside in Connecticut.

In closing, I respectfully ask the legislature to consider these points and to vote No to bill 5481. I believe this bill would result in a loss for the state, and a loss for thousands of small website operators who are desperately trying to make ends meet in this terrible economy.

Sincerely,

Tom Klein